IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

No. 660

MOLINE PROPERTIES, INC.,
Petitioner.

——vs.——

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

REPLY BRIEF OF PETITIONER

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TO THE HONORABLE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES.

Respondent asserts (brief p. 9) that the Court below did not hold that "in every instance a taxpayer who forms a corporation is precluded from showing the true nature of the arrangement so as to escape a tax disadvantage," and devotes much space to factual details claimed now to preclude invoking the "agency" doctrine, and he concludes his agrument (brief p. 11) by saying that the present case does not raise the question whether under any circumstances a taxpayer may invoke the "agency" doctrine. His position here is in sharp contrast to his argument in the Court below. There, confronted with the Board's ultimate conclusion of fact that Thompson had "full beneficial ownership" of the property, the corporation being "a mere figmentary

agent" (Rec. p. 21)[1], the respondent contended that a stand by the government requiring recognition of a "sham" corporation because it was to the advantage of the revenue "requires no apology in the light of the express language of *Higgins* v. *Smith*." And in his letter[2] to the Clerk of the Court below, in response to the taxpayer's petition for rehearing, respondent asserted that "actually" the decision of the Court below "was that the Board had erred in its application of legal principles to the facts before it," and that the question was "not whether a given transaction * * * was a reality or a sham, but whether a voluntarily selected form for carrying on a business could be disavowed when a tax saving might result."

Thus, when confronted with an adverse factual determination by the Board respondent argued in effect that the "agency" doctrine can never be invoked. Yet here he asserts that the "facts" distinguish the present case from those in which the "agency" doctrine has been successfully invoked by taxpayers, notably the *Brager* case, 124 Fed. (2d) 349. A mere casual reading of that case makes clear the conflict between that and the decision below. The facts are if anything stronger in favor of the present taxpayer. The Board concluded that the corporation here was a mere agent, the beneficial ownership being in Thompson. This, if correct, would subject the profit to taxation against the beneficial owner, not the agent, a mere fiduciary, even if there were no such ownership of stock of the agent-fiduciary by the beneficial owner of the land. Nevertheless (and in the face of this Court's many decisions

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[1] Page 20 of the respondent's brief in the Circuit Court of Appeals. A certified copy of this brief is on file with the Clerk of this Court in docket No. 552, *Interstate Transit Lines* v. *Commissioner*.

[2] A certified copy of this letter is also on file with the Clerk of this Court in docket No. 552, *Interstate Transit Lines* v. *Commissioner*. For convenience this letter is reproduced, as an appendix to this reply brief, *infra*.

on the subject of the binding effect of factual decisions of administrative tribunals of first instance[1], the Court below, because of the supposed effect of the language in *Higgins* v. *Smith*, rejected the Board's express conclusion that there was an agency and that the beneficial ownership was in Thompson. The Court below could not have held that as a matter of law the evidence did not support the Board's conclusion; for patently the evidence does support the Board. The only possible ground on which this reversal can be upheld is that, as a matter of law, a taxpayer may never invoke the "agency" doctrine, in cases of this kind. Respondent's present emphasis on the facts, and some inaccuracies of statement, make necessary some further reference to some of the evidentiary facts on which the Board based its conclusion.

1. Respondent treats Thompson as a free agent "to adopt such organization for his affairs as he may choose" (quoting, on Page 7, from *Higgins* v. *Smith*), and argues further (p. 8) that the taxpayer corporation "was created to carry out a business purpose" (protecting creditors' investments and saving Thompson's equity). Yet respondent concedes (*ibid*) that at first "Thompson had no control over it (the corporation." Respondent argues that to treat the corporation as a "dummy" would be to negate the very reason for which it was brought into being." Yet that purpose (which was not Thompson's but the bank's) had already been fully accomplished by 1933 when, as respondent says (*ibid*), Thompson had become "simply in the position of a person taking over the stock of a corporation already organized and functioning." The Board held that Thompson was the beneficial owner. The corporation (irrespective of stock ownership and while admittedly Thompson "had no control over it") never did more than hold the equity for Thompson's beneficial account. Thompson's acquisition of the stock, on the termination

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[1]Compare *Helvering* v. *Rankin*, 295 U. S. 133, 55 S. Ct. 732, 79 L. Ed. 1343

of the voting trust in 1933 (brief p. 8), did not, without more, suddenly transform the corporation into the beneficial owner. Thompson did not at any time "adopt" the corporate organization for his affairs, as respondent repeatedly suggests. The organization of the corporation was not "voluntary." It was forced on Thompson. After 1933 the corporation certainly was a "dummy," whatever was its status in this respect prior thereto. At most all the corporation had was the naked legal title, beneficial ownership being at all times in Thompson, subject for a time to creditors' claims.

2. Seeking to convey the impression that Thompson's present predicament results from his own voluntary choice, respondent suggests (brief p. 3) that the arrangement eventuated from someone's "proposal" (which term connotes freedom to accept or reject it); and respondent also, in this connection, emphasizes (brief p. 6) language of the Court below to the effect that Thompson had "voluntarily chosen to organize petitioner to conduct certain business affairs." The fact is that Thompson was in desperate financial circumstances, a necessitous debtor at the time the corporation was organized, and wholly without any power of free choice beyond the harsh alternative of surrendering his equity or bowing to the bank's demand. Although he owned considerable property (Rec. p. 52) he did not in other situations employ the corporate device in the transaction of his affairs (Rec. p. 42). The testimony on the subject of Thompson's supposed volition in the matter is to the effect (Rec. p. 36) that the Bank of Bay Biscayne would lend some money urgently required for back taxes, but that "they were not going to do it" unless Thompson "authorized the bank to form a corporation in which to place title" to the property, and that after such formation he would "have to hypothecate all of the stock of the corporation to secure the tax money loan" and have to give a voting trust to some officer of the bank "to vote all the stock of the corporation at any time they saw fit." Thompson authorized

the bank's officer to "go ahead and form the corporation" *(ibid)* and "signed whatever was brought up there" to his office. He testified that Moline Properties, Inc., "was purely a receptacle to hold the title to this property in order to get the bank to loan that money, take care of the taxes." This testimony is without contradiction, and its substance is embodied in the findings (Rec. p. 17). It completely negatives the assertedly "voluntary" choice of the corporate form. The bank, not Thompson, demanded the corporation; the bank organized it; Thompson had little or nothing to say beyond the alternative of submission, or loss of his equity; and now, after struggling to save what little he had, his submission, upon what any normal person would treat as a mere matter of form, to the demand of an exacting creditor, is, by a strange perversion of the realities, characterized as his "voluntary" choice in the "organization for his affairs," and seized upon as an excuse, under the guise of taxation, to mulct him of the little he has salvaged from the debacle.

3. How completely without independence Thompson was is well illustrated by the transaction, mentioned on page 5 of respondent's brief and in the Board's findings (on page 18 of the Record), whereby the corporation, as respondent says (p. 5), "purchased from Biscayne a note of Thompson's together with a real estate mortgage securing it, in the amount of $43,000, on which interest of $9703.14 was due, at its face value plus accrued interest," for which the corporation is said to have given "its note for the purchase price, securing it with Thompson's mortgage, which it received on the purchase of the note." This extraordinary and fraudulent transaction is fully explained in Thompson's testimony (Rec. p. 42 ff; see also exhibit 1, Rec. p. 71). The minutes purportedly authorizing the transaction (Exhibit 1, Rec. p. 71) were prepared by the bank's personnel and falsely recited Thompson's presence at the meeting. He was not there in fact (Rec. p. 43). The

transaction was "just some bank juggling" which "caused them all to be indicted" (Rec. p. 44). Thompson "never heard of that minute until all of these mortgages were liquidated" and the corporate records and minute book turned back to him (Rec. p. 43)[1].

4. In respondent's discussion of certain evidentiary facts (on pages 4 to 6 of his brief) he *omits* the following:

a. Thompson was personally obligated on the notes secured by the mortgage and "was never at any time relieved of liability on the mortgage, personal liability, because there never was any substitution of notes." (Rec. p. 38).

b. When the loan was negotiated with National Investment Holdings (brief p. 4) the checks representing the proceeds were made payable to Thompson (Rec. p. 40).

c. In the case of the suit to remove certain restriction, as to which respondent says (brief p. 5) that Thompson paid $4,005.39 *of* the expenses; the fact is that the Board found that Thompson had paid this amount in 1933 (Rec. p. 18); but the testimony also shows that the *entire* fee was paid by Thompson, that payments for Thompson's account were made by the bank to the lawyers; and that Thompson "was not even consulted about that" except that he had, before the corporation was formed, authorized the bringing of the suit and knew that fees would be charged against him (Rec. p. 41). The taxpayer corporation obviously

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[1] Thompson testified (Rec. pp. 44, 45): "I signed whatever the bank sent over there. I was obligated to the bank. If they drew a paper and sent it over there I signed it. I never asked any questions. I was not in a position to ask questions. It related to Moline Properties. They had a voting trust to do as they pleased, and I had confidence in everything that the bank was doing. But that is a pure bogus piece of shenanigan."

never paid any part whatever of these fees, for it never had any funds.

d. In the case of the condemnation suit (referred to on page 5 of respondent's brief) the testimony shows a reference to it in the false minutes of that meeting Thompson did not attend (Rec. p. 48), that there were condemnation proceedings, that the Clerk of Court handed Thompson as President of Moline Properties a check for $6,500 which was "sent over to the Beach Bank and turned over to one of Thompson's creditors" but that Thompson did not "want to be bound by that minute" but did know where the money went. (Rec. p. 48). The record owner of the title was necessarily the party to the condemnation suit[1]; a circumstance that in no way alters the fact that the agency-fiduciary relationship in fact existed, as the Board found.

e. All moneys received from sales and for the 1934 rental (brief p. 6) were received by Thompson and dealt with as his own, as he had a right to do, he having, as the Board held, the beneficial ownership. He testified (Rec. p. 45) that he received the money from the sales, which was deposited in his own bank account. It does not affirmatively appear from the record in whose account the rent money was deposited, but as the corporation had no account and Thompson had the beneficial ownership, it is a fair inference from the entire testimony that he also himself received this relatively small sum.

f. There is nothing in the record to suggest that Thompson conceived the formation of Moline Properties to fraudulently evade payment of taxes.

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[1]The corporation did not bring the suit; it was brought against it. (Rec. p. 55).

The very authorities cited by respondent emphasize the confusion in the law. The *Brager* case, 124 Fed. (2d) 349, is distinguished on the shadowy ground that the corporation there was "of a 'purely nominal character' which 'had no business activities and served no purpose other than the passive holding of the legal title' to property" (brief p. 10). That is the present case, especially after 1933. As to the period prior to 1933, Thompson's moral and equitable position here stands on a far stronger footing than that of the interested parties in the *Brager* case; for there they were under no compulsion and were indeed acting voluntarily in their own interest, while here Thompson did what an exacting creditor told him to do. The significance is not apparent of the shadowy additional distinction suggested (in the footnote on page 10 of respondent's brief), namely, that the corporation in the *Brager* case "did not assume the mortgage debt against the property transferred to it." Moline's nominal assumption of Thompson's personal obligation added nothing to that obligation, and was in pursuance of a formal arrangement dictated by the bank. The conflict between the present and the *Brager* case is too plain for further discussion.

But, says respondent (brief p. 10, footnote), "It is questionable whether the same result would have been reached by the Fourth Circuit in the *Brager* case if that case had been decided after the reversal of its decision in *Powell* v. *Gray*, 114 Fed. (2d) 752 (C.C.A. 4th), in which this Court, citing *Higgins* v. *Smith*, *supra*, stated (314 U. S. 402, 414): 'The choice of disregarding a deliberately chosen arrangement for conducting business affairs does not lie with the creator of the plan'." It does not follow, however, that if the "deliberately chosen" corporation, in cases of this kind, is in fact a mere agent or fiduciary, the taxpayer is precluded from showing such actual relationship. That is what the Fourth Circuit held, in effect, in the *Brager* case. If, for example, Thompson had conveyed the property to a

corporation trustee whose stock he did not own, no one would contend that that corporation, not having the beneficial ownership, should merely by virtue of its bare legal title be taxable on profits of the beneficial owner. That, however, is in effect the holding of the Court below; for it rejected the Board's conclusion that an agency existed, and that Thompson was the beneficial owner. Respondent's citation of this Court's decision in *Gray* v. *Powell*, 314 U. S. 402,62 S. Ct. 326, 6 L.Ed. Ad.Op. 285, overlooks the fact that that decision rests upon the controlling effect of the administrative determination of the tribunal of first instance that the railroad receiver was not the "producer." What was actually decided in *Gray v. Powell* requires a reversal of the Fifth Circuit decision below, and an affirmance of the Board of Tax Appeals.

Perhaps decisions "piercing the corporate veil" have confused the subject because of language to the general effect that courts will look through the corporate fiction where necessary in certain situations. As a matter of fact the result, at least in cases upholding the "agency" doctrine in a taxpayer's favor, can frequently be supported on the ground that the evidence shows an agency in fact, so that the corporation, though seemingly the principal actor, is but an agent, or fiduciary, for another. Stock ownership by the beneficially interested party may be merely one circumstance in a collection of evidentiary facts, all establishing agency. The significance of the economic interest of the stockholder in his corporation may sometimes obscure, or confuse, the essential fact, which is not whether stockholder and corporation are one, but whether the corporation is acting for itself or as agent for another. The present case is a particularly favorable one for clarification of the law; for here the Board's ultimate conclusion of fact, binding under this Court's decisions on appellate tribunals, is that there was an agency, in fact.

The decision below was a clear miscarriage of justice. It shocks the conscience when reviewed in the light of

the facts and the Board's findings. It should not be allowed to stand unless compelled by clear rules of law, which it obviously is not. The price of submission by a necessitous debtor to his creditor's compulsion, onerous enough at best, should not, especially under the high tax rates of these times, include what is in reality confiscation by the tax collector. The high tax rates of the past few years make it more than ever necessary that realities only be considered and that true income only be taxed and to the person to whom it beneficially accrues. Otherwise the tax laws, complicated and burdensome at best, will be mere traps for the unwary, who, like Judge Thompson, know "nothing about income tax law" (Rec. p. 45), while those able to employ skilled advisors may avoid such pitfalls, and even escape taxes that should in fairness be paid. It is earnestly submitted that this case is therefore peculiarly appropriate for review by this Court, to the end that the confusion in the law be clarified.

Respectfully submitted.

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Attorneys for Petitioner.

THOS. H. ANDERSON,
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Attorneys for Petitioner.

APPENDIX A

Copy of Attorney General's letter to Clerk of the Circuit Court of Appeals for the Fifth Circuit in response to taxpayer's petition for rehearing filed herein November 28, 1942, is as follows:

"SOC
5-7069 BMB:fs

December 7, 1942

Oakley F. Dodd, Clerk

United States Circuit Court of Appeals
for the Fifth Circuit,

New Orleans, Louisiana

Re: *Commissioner v. Moline Properties,*
Inc., No. 10279

Sir:

A copy of the taxpayer's petition for rehearing, filed on November 28, 1942, has been received. Because the matters therein stated were fully discussed in the briefs of the parties and in the argument before the Court, and add nothing new to be considered, this office does not propose, unless request should be made by the Court, to file a formal reply.

The substance of the petition appears to be that this Court has unjustifiably reversed a decision of the Board on a question of fact. Actually, however, the decision of this Court was that the Board had erred in its application of legal principles to the facts before it. The taxpayer also complains (Pet. 4) that there is nothing in the record or the Board's findings to show that the form employed for doing business was unreal or a sham. Presumably, the absence of such evidence and such a finding

tends to sustain the Commissioner's position. The question here was not whether a given transaction, such as a sale from a stockholder to his corporation, was a reality or a sham, but whether a voluntarily-selected form for carrying on a business could be disavowed when a tax saving might result.

Respectfully,

For the Attorney General,

Samuel O. Clark, Jr.,

Assistant Attorney General."

CC: R. H. Eyles,
Seybold Building,
Miami, Florida

Douglas D. Felix,
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Miami, Florida

APPENDIX B

The Prentice Hall organization, one of the two standard recognized "services" on the subject of taxation, had the following comment in a recent "What's Happening" release (of November 28, 1942):

"DISREGARDING CORPORATE ENTITY

Can the corporate form be disregarded in determining tax consequences of operations of property held by corporation? Question often arises in connection with "dummy" real estate corporations. Sole stockholder claims he and corporation are one and the same. Hence, he argues, no tax should be imposed on corporation; its income or loss should be treated as his individual income or loss.

BTA has upheld argument in many cases. Recently, Fourth Circuit rules likewise in a well considered opinion (*U. S.* v. *Brager*, 124 Fed. (2d) 349). More recently, Second and Fifth Circuits have held to the contrary: *Watson* case from 2nd Circuit (124 Fed. (2d) 437), holding sole stockholder could not deduct corporation's operating loss; *Moline* case from 5th Circuit (11/7/42) holding income taxable to corporation and not to its sole stockholder.

OBSERVATION 1. Conflict among Circuits indicates possibility that question may be settled soon by Supreme Court. Meanwhile those concerned (both stockholder and corporation) should take appropriate steps to insure refunds in event of favorable decision.

OBSERVATION 2. It is settled that the *government* may disregard the corporate entity when used to commit fraud, or for tax evasion purposes (*Higgins* v. *Smith*, 308 U. S. 473)."